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JAMES R. BROWNING, Clerk

IN THE

Supreme Court of the United States

OCTOBER TERM, 1958

No. 624

EUGENE J. ARNFELD and HENRY J. MOSES, Executors of the Estate of ANDREW WINEMAN, Deceased, and EUGENE J. ARNFELD and MORTIMER H. MEYER, Successor Executors of the Estate of ELSA WINEMAN, Deceased, *Petitioners*,

v.

THE UNITED STATES OF AMERICA, *Respondent*.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF CLAIMS

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v.

THE UNITED STATES OF AMERICA, *Respondent.*

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF CLAIMS

The petitioners, Eugene J. Arnfeld, et al., pray that a writ of certiorari issue to review the judgment of the Court of Claims in the above-entitled case.

OPINION BELOW

The opinion of the Court of Claims is not yet officially reported but is set forth in Appendix I, *infra*, pp. 1a-16a.

JURISDICTION

The judgment of the Court of Claims was entered on July 16, 1958. On October 8, 1958, that court overruled the petitioners' timely motion for rehearing. The jurisdiction of this Court is invoked under 28 U.S.C. 1255(1).

QUESTION PRESENTED

Did the taxpayer realize capital gain or ordinary income from the *bona fide* sale of an annuity policy held for more than six months, the sale having occurred before the maturity date of the annuity and before there accrued to the seller any ordinary income under the terms of the policy?

STATUTES AND REGULATIONS INVOLVED

The statutory provisions involved are Sections 117(a)(1), (a)(4) and (b) of the Internal Revenue Code of 1939, and the Regulations involved are Treasury Regulations 111, Sec. 29.117-1, all of which are set forth in Appendix II, *infra*, pp. 18a-19a.

STATEMENT

The petitioners are the duly qualified executors of the Estate of Elsa Wineman and her husband Andrew Wineman (R. 28).

On January 6, 1933, Andrew Wineman purchased a variable deposit annuity policy, making an initial deposit of $10,000 (R. 28). Five days later he assigned the policy to his wife, Elsa (R. 28). The policy was due to mature on January 6, 1951, when Andrew Wineman would become 70 years of age (R. 28). Elsa Wineman made additional deposits of $71,000

during her ownership of the policy (R. 31). On January 3, 1951, prior to its maturity, Elsa sold the policy to an unrelated third party (R. 30). The court below specifically found that the sale was *bona fide* (R. 23, 24, 31). The agreed selling price was $117,000 (R. 29) and Elsa realized a gain of $36,000 over her cost (R. 32). The buyer (who is not a party in this proceeding) elected to surrender the policy, and on January 15, 1951, after the maturity date of the policy, he received from the issuing insurance company the sum of $117,330.14 (R. 30-31). After deducting his costs the buyer reported his net profit on the transaction as ordinary taxable income (R. 31).

The Winemans filed a joint Federal income tax return for 1951, in which they reported the $36,000 as a long term capital gain from the sale of a capital asset (R. 31-32). The Commissioner of Internal Revenue determined that the gain was ordinary income (R. 32) and the court below sustained that determination.

REASONS FOR GRANTING THE WRIT

Certiorari is requested on the following grounds:

1. The Decision Below is in Conflict With Decisions of This Court, the Courts of Appeal, and the Tax Court.

The holding of the lower court that the gain realized by Elsa Wineman from the sale of her entire interest in an annuity policy was not a capital gain, because it "would in time constitute ordinary income," (Appendix I, p. 9a) is in conflict with the holding of this Court in *Blair* v. *Commissioner*, 300 U.S. 5 (1937); and is also in direct conflict with the holding of the Courts of Appeal for the Second and Eighth Circuits

in *McAllister* v. *Commissioner*, 157 F. 2d 235 (1946), cert. den. 330 U.S. 826 (1947), and *Bell's Estate* v. *Commissioner*, 137 F. 2d 454 (1943), respectively.

The decision below is also in direct conflict with the recent decision of the Tax Court of the United States in the case of *Percy W. Phillips*, 30 T.C., No. 87 (decision entered on September 23, 1958). In that case, on facts indistinguishable from those here, the Tax Court concluded that the gain realized from the *bona fide* sale of a similar policy resulted in capital gain. That case was appealed to the Court of Appeals for the Fourth Circuit on December 22, 1958, and if affirmed, there will exist a direct conflict between the Court of Claims and a Court of Appeals on the tax consequences of the sale of annuity and endowment insurance policies which this Court ought to settle definitely.

In *Blair* v. *Commissioner*, *supra*, this Court held that a taxpayer's irrevocable assignment to his children of $9,000 per year interests in a life estate of which he was the life beneficiary was not an anticipatory assignment of income and that the assignees rather than the taxpayer were the proper persons to whom the Government should look to collect the tax on such amounts of income. This Court reasoned that the yearly income payments which the children received arose from their ownership of a part of the taxpayer's equitable interest in the life estate because after the assignment, the taxpayer had no further interest in or control over that part of the estate which had been given to them. This Court said the right to the income there in question was so identified with the ownership of the property produc-

ing it, that a gift of the income was impossible without a gift of the property.

Applying that principle to the case at bar, it was the buyer and not the seller of the annuity policy who realized ordinary income when the annuity policy matured *after the sale.* As in *Blair,* when Elsa Wineman sold the policy she divested herself of the entire property which would produce the future income, and had no ownership interest whatever when that future income was realized by the purchaser. Cf. *Helvering* v. *Horst,* 311 U. S. 112, where there was no transfer of the income producing property, but only of the right to income realized later in the same taxable year. On the date of sale of the whole property interest in the annuity, Elsa Wineman was entitled to nothing from the insurance company which issued the policy because the maturity date had not yet arrived. That is precisely what this Court held with respect to the taxpayer in the *Blair* case. He had parted with the property before the income therefrom had been realized, and he was therefore not taxable on such income when later received by the transferees.

Moreover, in the present case, even at the maturity date, had Elsa still been the owner, she could have elected to receive a life income instead of surrendering the policy for redemption. In this latter event, Elsa would have realized taxable income only in the future years as she received the annuity payments. Section 22(b)(2) of the 1939 Internal Revenue Code. And the judicial authorities are in agreement that if she had sold her property interest in the annuity after having elected the life income option, any gain realized by her would have been capital gain. See *McAllister* v. *Commissioner, supra,* and *Bell's Estate* v. *Commissioner, supra,* the Courts of Appeal for the Second and

Eighth Circuits held that the gain arising from the sale of an entire interest in a life estate was a capital gain rather than ordinary income.

The controlling facts of the instant case are indistinguishable from those in *Blair*, *McAllister* and *Bell's Estate*. In those cases the taxpayers sold or assigned their full property interest in an income-producing asset. In both *McAllister* and *Bell's Estate* the sale price undoubtedly was determined in part by the discounted value of the future earnings which ownership of the assets would produce.

Here, also, Elsa Wineman sold her full and complete interest in the annuity policy. A part of the price which she received represented the discounted value of the future income which the policy would have produced had she held it to maturity and thereafter received periodic income payments. In both *McAllister* and *Bell's Estate*, the fact that the taxpayers forever disposed of all of their interest in the income-producing property was thought to be controlling and hence resulted in the gain being taxed as capital gain.

Despite the indistinguishable pattern of the facts there and here, the court below held that Elsa Wineman could not, by selling the asset itself before the right to the income had accrued, "convert what would in time constitute ordinary income under section 22(b) into capital gain." The court below did not dispute the fact that the annuity policy was a capital asset and specifically held that Elsa Wineman had irrevocably parted with all of her right, title and interest to the policy in a *bona fide* sale. In the face of those facts it is obvious that the

court below ought to have but failed to apply the rule established by this Court in *Blair* v. *Commissioner, supra,* to the instant case. In alluding to *Commissioner* v. *P. G. Lake, Inc.,* 356 U. S. 260 (1958), as authority for its conclusion, the court below failed to observe the fundamental distinction between *Blair* where there was a complete and irrevocable disposition of income-producing property and *Lake* where there was only a three year assignment of part of the income from oil property. This Court emphasized this distinction in *Harrison* v. *Schaffner,* 312 U. S. 579, at pp. 582-583:

> "... We think that the gift by a beneficiary of a trust of some part of the income derived from the trust property for the period of a day, a month, or a year involves no such substantial disposition of the trust property as to camouflage the reality that he is enjoying the benefit of the income from the trust of which he continues to be the beneficiary, ..."

Here there was no temporary disposition "of some part of the income derived from the ... property for the period of a day, a month, or a year" as there was in *Lake.* Elsa Wineman sold her complete interest in an income-producing capital asset prior to the time the right to income therefrom accrued. The principles established by this Court in *Blair* require the gain on such sale to be taxed as a capital gain.

Underlying the decision of the court below is the erroneous notion that a taxpayer cannot avoid the tax on future income by disposing of the income-producing property before right to such income has accrued. This idea is directly contrary to long-established and thoroughly sound principles embedded in

our tax laws as the *Blair* case illustrates. Similarly, under the Code itself, if a capital asset is sold five months and 29 days after acquisition, any gain realized will be ordinary income, but if held for six months and one day the same gain will be taxed as capital gain. Section 117 of the 1939 Code and Section 1201 et seq. of 1954 Code. Likewise, the courts, including this Court, have always been careful to protect the right of a taxpayer to take any *bona fide* action he chooses to reduce his taxes so long as he observes the provisions of the tax laws. In *Gregory* v. *Helvering*, 293 U.S. 465, this Court said (p. 469):

> "The legal right of a taxpayer to decrease the amount of what otherwise would be his taxes, or altogether avoid them, by means which the law permits, cannot be doubted."

The court below expressly recognized this principle, citing the *Gregory* case. Appendix I, p. 7a. However, it wholly failed to apply such principle to the case before it. Instead of giving effect to the tax consequences of the sale of the policy, the court approved the imposition of the tax just as though no sale had been effected and Elsa Wineman had continued to own the policy to maturity. Thus, the court's decision ignores the actual transaction and imposes the tax on "what would in time constitute ordinary income."

2. The Decision Below Raises an Important Question in the Administration of the Tax Laws Which Has Not Been But Should be Decided by This Court.

Until the decision of the court below, it had long been recognized that the present commuted value of expected future earnings from a capital asset, which

had neither accrued nor were otherwise payable, was taxable as a long term capital gain when realized by a cash basis taxpayer upon the *bona fide* sale of his entire interest in such asset. For the first time, a lower court taxes as ordinary income the gain presently realized by a cash basis taxpayer from the *bona fide* sale of a capital asset because the asset would someday produce an equivalent or greater gain which would be so taxable under Section 22(b)(2) if received in future years in periodic payments. The fact that the Tax Court in the *Phillips* case reached precisely the opposite conclusion emphasizes the pressing importance of this question and demonstrates the uncertainty and confusion created by the decision below to the Treasury in the administration of the tax laws and to the many owners of annuity and insurance policies.

The importance of the immediate question raised herein is further emphasized by the fact that the holding of the lower court has implications far beyond the factual limits of the present proceeding. Its decision can apply not only to annuity policies but if permitted to stand must logically be extended to all income producing capital assets. Hence, when any capital asset is sold for a price which may include the present commuted value of future anticipated income, the gain would be taxable as ordinary income rather than as long term capital gain. If permitted to stand, that holding can only create confusion and uncertainty in an area of great importance in the administration of the revenue laws.

Alternative Request That Petition be Held in Abeyance Pending Decision of the Fourth Circuit in the Phillips Case.

As heretofore stated, the Government has appealed the decision of the Tax Court in the case of *Percy W. Phillips, supra,* on precisely the same issue. An affirmance of the decision of the Tax Court by the Fourth Circuit will create a direct conflict with the decision below in the instant case. This Court should grant certiorari now because the question is an important one on which an actual conflict exists and a petition in the instant case after affirmance in *Phillips* would be untimely and contrary to the rules of this Court, Rules 38 and 58(4).

In the alternative, and in the event this Court is not disposed to grant certiorari at this time, it is suggested that this petition be held in abeyance pending the decision by the Court of Appeals in the *Phillips* case.

CONCLUSION

The petitioners respectfully request this Court to grant their petition for certiorari and reverse the decision of the court below, or, in the alternative, to hold in abeyance this petition pending the decision by the Court of Appeals in the *Phillips* case.

Respectfully submitted,

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APPENDIX I

Opinion of Court Below

IN THE UNITED STATES COURT OF CLAIMS

No. 477-55

(Decided July 16, 1958)

EUGENE J. ARNFELD AND HENRY J. MOSES, EXECUTORS OF THE ESTATE OF ANDREW WINEMAN, DECEASED, AND EUGENE J. ARNFELD AND MORTIMER H. MEYER, SUCCESSOR EXECUTORS OF THE ESTATE OF ELSA WINEMAN, DECEASED

v.

THE UNITED STATES

Mr. Joseph H. Sheppard for the plaintiffs. *Messrs. J. Marvin Haynes, Haynes & Miller, N. Barr Miller,* and *Arthur H. Adams* were on the briefs.

Mr. David R. Frazer, with whom was *Mr. Assistant Attorney General Charles K. Rice,* for the defendant. *Mr. James P. Garland* was on the brief.

OPINION

JONES, *Chief Judge,* delivered the opinion of the court:

Plaintiffs, executors of the estates of Andrew and Elsa Wineman, sue to recover income taxes and deficiency interest for the year 1951. The amount claimed is $25,494.25.

The issue presented for our determination is whether the increment realized by taxpayer Elsa Wineman upon the transfer of an annuity contract prior to its maturity constitutes ordinary income or capital gain.

The annuity contract in question was acquired by Andrew Wineman on January 6, 1933, and thereafter was assigned

to his wife, Elsa Wineman, on January 11, 1933. Issued by the Penn Mutual Life Insurance Company, the policy was an 18-year optional deferred income contract, to mature when the insured reached the age of seventy years. Part of the contract consisted of a variable deposit rider which permitted deposits at any time by the insured or his assignees. The aggregate deposited was not to be in excess of $100,000, unless the company should waive such limit. The maturity date of the policy was January 6, 1951.

The contract was purchased by Andrew Wineman from a Howard A. Kaichen who, at the time, held a general agency contract with the Penn Mutual Life Insurance Company. Kaichen represented that company as a general agent from 1932 until 1941 when his contract was terminated. He thereafter had no connection with the Penn Mutual company.

The optional deferred income contract was first called to Andrew Wineman's attention by Kaichen in late 1932. The early depression years had seriously undermined financial conditions in Detroit, Michigan, where Andrew Wineman resided and carried on his business. As a result, those who had invested in stocks, bonds, and real estate began to witness the decline of their property values. To meet the needs of such persons, by way of providing a conservative investment, the Penn Mutual Life Insurance Company, along with other insurance companies, began offering policies of the type purchased by Wineman.

With the coming of the postwar inflationary spiral, however, conservative investments such as reflected in the optional deferred income contract became less attractive than other investments. For that reason, Wineman thought that he had made a poor investment. His misgivings turned to criticism of Kaichen for inducing him to purchase the annuity contract. Because of such criticism, Kaichen finally suggested to Wineman that he sell the policy and use the proceeds to acquire common stock or other more profitable

securities. Kaichen thought it advisable to sell the policy, rather than surrender it to the insurer for its cash surrender value, because he believed that an income tax saving could thereby be realized. His belief concerning the tax consequences of such a transaction was confirmed by Wineman's regularly employed accountants after consultation with their Washington, D. C., office. Briefly, Wineman's accountants informed him that if a bona fide sale of the policy were made, the Treasury Department would treat any profit derived therefrom as long-term capital gain instead of as ordinary income.

Kaichen thereafter suggested that the annuity contract be sold to the National Bank of Detroit, since he had no intention of purchasing it himself. Following this suggestion, Wineman went to the bank on January 3, 1951, accompanied by Kaichen. They were informed by the vice president of the bank that, since the National Bank of Detroit was a national bank, it was precluded by law from making the purchase. The vice president did suggest, however, that the bank would loan Kaichen $117,000, the agreed selling price of the contract, on Kaichen's note with the policy as collateral if he would buy the policy.

On the same day, Elsa Wineman transferred the policy to Kaichen at the agreed price of $117,000. This amount was borrowed from the bank pursuant to the above mentioned agreement, with the policy assigned as collateral.

On January 4, 1951, the National Bank of Detroit mailed the policy to the Penn Mutual Life Insurance Company, along with a letter requesting that the policy's cash surrender value be forwarded to the bank. The following day, January 5, 1951, Kaichen issued his check to Elsa Wineman for $117,000, and thereby satisfied the purchase price of the insurance policy. The cash surrender value of the policy, amounting to $117,330.14, was received by the bank on January 15, 1951. This amount was applied by the bank in payment of Kaichen's loan and the accrued interest thereon.

The balance of $240.77 was then applied to Kaichen's special account.

At the date of acquisition of the annuity contract, January 6, 1933, Andrew Wineman made an initial payment of $10,000. Thereafter, deposits in variable amounts were made by Elsa Wineman. The last deposit was on March 4, 1949. Total payments on the policy aggregated $81,000, which was the cost basis of the contract at the time it was transferred by Elsa Wineman to Howard A. Kaichen.

Taxpayers Andrew and Elsa Wineman filed a joint income tax return for the calendar year 1951. The sum of $36,000, being the difference between the cost of the policy and the $117,000 paid by Howard A. Kaichen for its transfer, was reported in the return as capital gain. Subsequently the Commissioner of Internal Revenue determined that such profit amounted to ordinary income. The additional taxes resulting from this determination were duly paid. Claims for refund were filed and later rejected by the Commissioner.

Eugene J. Arnfeld and Henry J. Moses are the duly appointed executors of the estate of Andrew Wineman, who died in 1954. Elsa Wineman died in 1952. Plaintiffs Eugene J. Arnfeld and Mortimer H. Meyer are the executors of her estate.

The Government initially challenges plaintiffs' contention that the profit realized upon the transfer of the annuity contract prior to maturity constitutes capital gain by denying that the transfer was a bona fide "sale or exchange" of property within the meaning of section 117 (a) (4) of the 1939 Code.[1] The Government's argument that a *bona*

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[1] Internal Revenue Code of 1939:

"§ 117. Capital gains and losses—(a) Definitions.
"As used in this chapter—
"(1) Capital assets.
"The term 'capital assets' means property held by the taxpayer

fide sale or exchange did not take place can be summarized as follows: The transaction was one of accommodation between the National Bank of Detroit, Kaichen, and Andrew Wineman, with the bank and Kaichen acting as agents for Wineman for the purpose of transferring the annuity policy out of Wineman's hands and into the hands of a third party. Thus Kaichen was no more than a conduit through which the "form" of a sale took place.

However, we feel that the broad sweep of this objection, if sanctioned as to the instant facts, could strike at the heart of any sale or exchange. For it is not clear to us just what standards of "horse trading" the Government

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(whether or not connected with his trade or business), but does not include—

"(A) stock in trade of the taxpayer or other property of a kind which would properly be included in the inventory of the taxpayer if on hand at the close of the taxable year, or property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business;

"(B) property, used in his trade or business, of a character which is subject to the allowance for depreciation provided in section 23 (*l*), or real property used in his trade or business;

"(C) a copyright; a literary, musical, or artistic composition; or similar property; * * *

* * * * *

"(D) an obligation of the United States or any of its possessions, or of a State or Territory, or any political subdivision thereof, or of the District of Columbia, issued on or after March 1, 1941, on a discount basis and payable without interest at a fixed maturity date not exceeding one year from the date of issue.

* * * * *

"(4) Long-term capital gain.

"The term 'long-term capital gain' means gain from the sale or exchange of a capital asset held for more than 6 months; if and to the extent such gain is taken into account in computing gross income;

* * * * *

"(b) Deduction from gross income.

"In the case of a taxpayer other than a corporation, if for any taxable year the net long-term capital gain exceeds the net short-term capital loss, 50 per centum of the amount of such excess shall be a deduction from gross income. * * *" [26 U. S. C. (1952 ed.) § 117.]

would have us impose on the business community before we could say that a valid and binding sale had occurred. At the least, it would require businessmen to strike a hard bargain. But such was done here. The bank realized interest on its loan to Kaichen. Kaichen was compensated for his part in the transaction. Further, the trial commissioner's report indicates that Kaichen, when he purchased the annuity policy from Elsa Wineman, was acting in his individual capacity and not as the agent of any company or person. We are satisfied, after examining the record, of the correctness of that determination (finding 11).

More specifically, the Government urges that we view the instant case against the factual background present in *Lasky* v. *Comm'r*, 22 T. C. 13 (1954), dismissed 235 F. 2d 97 (1956), affirmed 352 U. S. 1027 (1957). In that case the taxpayer assigned his right in accrued royalties of $820,000 to United Artists for $805,000. A few days later United Artists released the right to Warner Brothers for $820,000, the amount of the accumulated royalties. The court rejected petitioner's claim that the receipts constituted capital gains, and held the amount received to be ordinary income. Prior to the assignment the taxpayer in *Lasky* could have collected the royalties at any time since they carried no maturity date with them. According to the Government's interpretation of that case, there was, therefore, no benefit derived by the taxpayer on the assignment, and such was the basis for the court's decision. Similarly here there was no benefit, argues the Government, derived by Wineman on the assignment of the annuity policy—as a matter of fact, assignment of the policy prior to maturity cost Wineman the difference between the maturity value and the sales price, i. e., $330.14. But assuming the Government's interpretation of the holding in *Lasky* is correct, it cannot be said that Wineman derived no benefit from the assignment of the annuity contract. For, as mentioned above, a business purpose guided Andrew Wineman in his initial determination to dispose of the policy: the proceeds

of such disposition were to be invested in securities yielding a higher rate of return. His *method* of disposition, however, in electing to sell the policy to a third person rather than surrender it to the issuing company for its cash surrender value was clearly designed to lessen his taxes.[2] But such is the legal right of a taxpayer. *Gregory* v. *Helvering*, 293 U. S. 465 (1935); *Comm'r* v. *Tower*, 327 U. S. 280 (1946).

Finally, we have no quarrel with the Government's assertion that substance rather than form determines the tax consequences of a given transaction. We have examined the "substance" of this case and find ourselves in agreement with a statement made by counsel for plaintiffs: in the present case the form of the transaction fully disclosed its substance.

The second objection raised by defendant calls for more detailed analysis. It would require us to treat the gain realized on the transaction as ordinary income rather than as capital gain. As already indicated, Andrew Wineman made an initial payment of $10,000 on the contract at the time of purchase. Following the assignment of the policy to his wife, Elsa Wineman made various deposits in variable amounts on the contract. The last payment was made on March 4, 1949. At that time the total payments aggregated $81,000—the cost basis of the contract for tax purposes. The cash surrender value of the policy on its maturity date of January 6, 1951, amounted to $117,330.14. Of this sum, $330.14 represented the fee of the National Bank of Detroit and Kaichen for their part in the transaction. The balance of the proceeds, measured by the consideration paid for assignment of the contract, was received by Elsa Wineman. The difference between the amount received and the cost

[2] Had the taxpayer here surrendered the policy to the insurer the gain would have been taxable as ordinary income. *Avery* v. *Comm'r*, 111 F. 2d 19 (1940); *Bodine* v. *Comm'r*, 103 F. 2d 982 (1939).

basis of the annuity contract, i. e., $36,000, is the amount we are now asked to treat as ordinary income.

Counsel for the Government in oral argument directed our attention to the table under Section 5 of the annuity contract wherein is specified the death benefits and the loan or cash values of the policy prior to commencement of the life income payments. As his computations based on that table indicate, amounts deposited under the contract accumulate at 3½ percent interest compounded annually. Thus, the contract's rate of return is fixed. Bearing this fact in mind, the error becomes apparent in plaintiff's basic assertion that the gain realized by Elsa Wineman from the sale of the annuity policy is no different from the gain realized from the sale of corporate stock which has increased in value because of earnings accumulated and retained by the corporation over the period the stock was held by the taxpayer. Certainly it cannot be said that the enhancement in value of corporate stock, affected as it is by a myriad of economic factors, bears any material resemblance to the predictable growth in value of an annuity policy.

Looking to the taxing provision of the Internal Revenue Code of 1939 that would become operative upon maturity of the policy and commencement of the life income payments thereunder, it is to be seen that whether such payments would have been treated under section 22 (b) (2) as amounts received under an endowment contract or as amounts received as an annuity and therefore subject to the 3 percent rule would make no difference in treatment as to the nature of the gain realized under the policy.[3]

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[3] Internal Revenue Code of 1939:

"§ 22. Gross income—(a) General definition.

. . . . . .

"(b) Exclusions from gross income.

"The following items shall not be included in gross income and shall be exempt from taxation under this chapter:

Essentially, either method of taxation subjects gain under the policy to ordinary income treatment.

This being so, the issue here becomes one of whether plaintiffs can convert what would in time constitute ordinary income under section 22 (b) (2) into capital gain.

Courts have had occasion to pass upon the broader question of whether future income may be converted into capital gain a number of times. Moreover, the variety of transactions which have thereby been subjected to judicial review and the uniformity of decisions which have followed amply support the Government's position in this case.

The problem was considered in *Helvering* v. *Smith*, 90 F. 2d 590 (1937), where a retiring partner sought to treat as capital gain the proceeds from the "sale" of his interest in the earned fees of a partnership, both billed and unbilled, to the remaining partners. The court there refused to adopt the taxpayer's argument, emphasizing that as the partnership accounts were received they would constitute ordinary income. In the court's opinion, the "purchase" of that future income did not turn it into capital

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"(2) [as amended by sec. 120 (a), Revenue Act of 1942, c. 619, 56 Stat. 798] Annuities, etc.

"(A) In general.

"Amounts received (other than amounts paid by reason of the death of the insured and interest payments on such amounts and other than amounts received as annuities) under a life insurance or endowment contract, but if such amounts (when added to amounts received before the taxable year under such contract) exceed the aggregate premiums or consideration paid (whether or not paid during the taxable year) then the excess shall be included in gross income. Amounts received as an annuity under an annuity or endowment contract shall be included in gross income; except that there shall be excluded from gross income the excess of the amount received in the taxable year over an amount equal to 3 per centum of the aggregate premiums or consideration paid for such annuity (whether or not paid during such year), until the aggregate amount excluded from gross income under this chapter or prior income tax laws in respect of such annuity equals the aggregate premiums or consideration paid for such annuity. * * *" [26 U. S. C. (1952 ed.) § 117.]

any more than the discount of a note received in consideration of personal services.

Cases following have employed the same rationale. Thus in *Rhodes' Estate* v. *Comm'r*, 131 F. 2d 50 (1942), the taxpayer was denied capital gain treatment as to declared dividends on stock held by him when those dividends were sold to a third party shortly before they became payable. In *Fisher* v. *Comm'r*, 209 F. 2d 513 (1954), the court held that the consideration received upon the sale of a corporation's notes which were in default both as to principal and interest was taxable as ordinary income, and not as capital gain, to the extent that the payment received exceeded the face value of the notes. And in *Sorensen* v. *Comm'r*, 22 T. C. 321 (1954), an opinion reviewed by the full court, the Tax Court held that stock options which were granted as compensation by the taxpayer's employer gave rise to ordinary income upon their sale, and not capital gain as taxpayer contended.

The recent Supreme Court decision in *Comm'r* v. *P. G. Lake, Inc., et al.*, 356 U. S. 260 (1958), sheds additional light on this area. Under review in that case were oil payment rights, and in one instance a sulphur payment right, which were assigned by the taxpayers for present considerations. The Court held that the amounts received for the assignments were taxable as ordinary income, subject to a depletion deduction, and not as long-term capital gains. Plaintiffs, however, urge a distinction as to the *P. G. Lake* case, saying that it is in accord with the long line of established authority which holds that a taxpayer cannot assign future income to another and thus himself escape the tax on that income. But here, plaintiffs contend, Elsa Wineman was not selling or assigning only future income: she sold her entire ownership in an income-producing capital asset and thereby relinquished forever all rights thereto. In answer to plaintiffs on this point, we are unable to agree that a transfer of the entire asset is

dispositive of the case. Actually the law holds no certainty in this area, but the Supreme Court has indicated that the concept of "property" is not necessarily controlling in matters of taxation. In *Hort* v. *Comm'r*, 313 U. S. 28 (1941), the Court held that a sum received by a lessor for the cancellation of a lease was taxable as ordinary income despite the fact that the lease may for other purposes be treated as "property" or "capital". Since plaintiffs' asserted distinction is inconsistent with the principle of the *Hort* decision, we see no reason to adopt it.

This court is satisfied, after reviewing the above authorities, that the realized gain under the annuity contract in question should not be accorded capital gain treatment under section 117 of the Internal Revenue Code of 1939, but is properly taxable as ordinary income.[4]

The petition will be dismissed.

It is so ordered.

LARAMORE, *Judge;* MADDEN, *Judge;* WHITAKER, *Judge;* and LITTLETON, *Judge,* concur.

FINDINGS OF FACT

The court, having considered the evidence, the report of Trial Commissioner Wilson Cowen, and the briefs and argument of counsel, makes findings of fact as follows:

---

[4] Of the $117,330.14 paid by the Penn Mutual Life Insurance Company upon surrender of the policy, $521.38 represented accumulated dividends and $329.02 represented interest on those dividends. Whether the dividends were paid out of earnings and therefore taxable when received, G. C. M. 10798, XI-2 Cum. Bull. 58, *Florence Mae Shelley*, 10 T. C. 44, or were merely rebates on premiums, and therefore not taxable under Treasury Regulations 111, Sec. 29.22 (a)-12 does not affect the result of this case. Thus if they are true dividends they are taxable for the year received (1951). But if they are rebates on premiums they are treated as a return of capital and thereby serve to reduce the taxpayer's cost basis. Hence, even though there is a reduction of the cost basis of the annuity, the taxpayer's gain is exactly the same as if the dividends were taxable.

1. Plaintiffs, Eugene J. Arnfeld and Henry J. Moses, are executors of the Estate of Andrew Wineman, deceased. Plaintiffs Eugene J. Arnfeld and Mortimer H. Meyer are executors of the Estate of Elsa Wineman, deceased.

2. On January 6, 1933, Andrew Wineman, who resided in Detroit, Michigan, where he was engaged in business, purchased an annuity insurance contract from the Penn Mutual Life Insurance Company. At the time of the purchase, Wineman made an initial payment of $10,000 on it. The policy was an 18-year optional deferred income contract maturing when the insured attained the age of seventy years and carried a variable deposit rider which permitted deposits at any time by the insured or his assignees of any desired amounts not to exceed $100,000, unless such limit was waived by the company. The maturity date of the annuity contract was January 6, 1951.

3. On January 11, 1933, Andrew Wineman assigned the policy to his wife, Elsa Wineman.

4. The annuity insurance contract was sold to Andrew Wineman by Howard A. Kaichen, who is and for approximately twenty-six years has been a life insurance broker in Detroit, Michigan. At the time the policy was issued, he was licensed by the State of Michigan and held general agency contracts with several life insurance companies, including the Penn Mutual Life Insurance Company. Kaichen's contract with the Penn Mutual Life Insurance Company was in force from 1932 to 1941 when it was terminated. Thereafter, Kaichen had no connection with that company. During the years 1950 and 1951, Kaichen was self-employed as a life insurance broker. In 1932 and 1933, financial conditions in Detroit were very bad. Persons who had invested in stocks, bonds, and real estate realized that such investments were not as secure or as reliable as at the time the investments were made. In order to provide a conservative investment for such persons, the Penn Mutual Life Insurance Company and other

insurance companies evolved an optional deferred income policy of the kind which was purchased by Wineman. The advantages of this type of policy were first brought to Wineman's attention by Kaichen during the latter part of 1932 and, as already stated, the policy was issued on January 6, 1933.

5. In the inflationary period which followed World War II, the conservative investment provided by the above-described annuity policy became less attractive by comparison with other investments. As a result, Wineman frequently complained that Kaichen had induced him to make a poor investment. After repeatedly hearing such criticism, Kaichen suggested that the annuity policy should be sold and the proceeds invested in common stocks or other securities yielding a higher rate of return. The suggestion that the policy be sold rather than surrendered to the issuing company for the cash surrender value originated with Kaichen and was based upon his belief that such a disposition of the policy would result in an income tax saving. Upon Kaichen's advice that the income tax consequences of such a sale should be considered by a more competent source, Wineman consulted Lybrand, Ross Bros. & Montgomery, a public accounting firm which was regularly employed by Wineman in his business. The Detroit office of the accounting firm took the matter up with its Washington, D. C., office. As a result, Wineman was advised by his accountants that if a bona fide sale of the policy were made, the Treasury Department would treat any profit derived therefrom as long-term capital gain instead of as ordinary income.

6. Since he had no thought of purchasing the annuity policy personally, Kaichen suggested that it be sold to the National Bank of Detroit. On January 3, 1951, Wineman and Kaichen visited the bank for the purpose of disposing of the policy. They were not accompanied by Mrs. Wineman who was ill at the time. After an examination of the

policy, the vice president of the bank stated that since the National Bank of Detroit was a national bank, it was precluded by law from making the purchase. However, he suggested that Kaichen buy the policy and said that the bank would loan $117,000, the agreed selling price, on Kaichen's personal note, with the policy attached as collateral.

7. On January 3, 1951, Elsa Wineman transferred the annuity policy acquired by her on January 11, 1933, to Howard A. Kaichen, at the agreed price of $117,000. In order to pay for the policy, Kaichen borrowed $117,000 on his personal note from the National Bank of Detroit on January 4, 1951, and on the same day assigned the annuity contract to the bank as collateral for the loan. When he signed the note, the bank issued a deposit slip showing that the sum of $117,000 was deposited to Kaichen's special account on January 4, 1951. Kaichen and his wife had a joint checking account in the bank and, in addition, he had maintained a special account there since 1948 for the purpose of depositing any funds which he received from investments. At the time of the deposit of January 4, 1951, he had a balance of more than $5,000 in the special account. He had previously borrowed money from the bank but up to January 4, 1951, the largest loan he had obtained was in the amount of approximately $13,000.

8. On January 4, 1951, the National Bank of Detroit mailed the annuity policy to the Penn Mutual Life Insurance Company, along with a letter reading as follows:

> We hand you herewith Optional Deferred Income Policy No. 1727338 issued by you to Andrew Wineman, which policy was assigned by Andrew Wineman to Mrs. Elsa Wineman, an absolute assignment of said policy from Else [sic] Wineman to Howard A. Kaichen and a collateral assignment from Howard A. Kaichen to National Bank of Detroit.

We understand that the cash surrender value of said policy is $117,330.14 and we hereby surrender said policy to you with the request that the cash surrender value of said policy be forwarded to the National Bank of Detroit.

This letter is also signed by Mr. Howard A. Kaichen as owner and assignee for the purpose of confirming the instructions herein contained and for the purpose of evidencing his consent thereto.

9. On January 5, 1951, Kaichen issued his check to Elsa Wineman for $117,000, the amount he had agreed to pay her for the insurance policy.

10. On January 15, 1951, the National Bank of Detroit received $117,330.14, the cash surrender value of the policy from the Penn Mutual Life Insurance Company.[3] On the same date, the bank issued a deposit slip to Howard A. Kaichen showing that the sum of $117,089.37, representing the amount of his note to the bank, plus accrued interest, had been deducted from the total proceeds received from the insurance company and that his special account had been credited with the net sum of $240.77. This amount was reported by Kaichen in his tax return as income received in 1951.

11. When he purchased the annuity policy from Elsa Wineman, Kaichen was acting in his individual capacity and not as the agent of any company or person.

12. On January 4, 1951, Andrew Wineman was aware of the fact that Kaichen was making a profit of $240.77 upon the transaction and rasied an objection on that account. However, he waived his objection upon assurance from the vice president of the bank that Kaichen was entitled to

[3] Of the $117,330.14 cash surrender value of the policy, the sum of $521.38 represented accumulated dividends. Interest on those dividends was represented in the amount of $329.02.

earn a profit for the part he performed in the disposition of the policy.

13. After the initial payment of $10,000 on the annuity contract on the date of purchase, January 6, 1933, additional deposits in variable amounts were made by Elsa Wineman. The last payment was made March 4, 1949, at which time the total payments aggregated $81,000. At the time Elsa Wineman transferred the annuity contract to Howard A. Kaichen, her cost basis of the said contract was $81,000.

14. The amounts set forth in tabular form in section 2, "TABLE OF AMOUNTS OF MONTHLY LIFE INCOME PAYMENTS PURCHASED BY DEPOSITS", and section 5, "DEATH BENEFITS AND LOAN OR CASH VALUES PRIOR TO COMMENCEMENT OF LIFE INCOME PAYMENTS", of the annuity contract indicate that amounts deposited under the contract accumulate at 3½ percent interest compounded annually during the life of the policy.

15. Andrew Wineman and his wife, Elsa, filed a joint income tax return for the calendar year 1951 and paid the tax reported therein in the amount of $181,443.33. In the return, the sum of $36,000, representing the difference between the cost of the policy and the $117,000 received from Howard A. Kaichen for the transfer of the policy, was reported as capital gain. Subsequently, the Commissioner of Internal Revenue made a final determination that the taxpayers were liable for additional income taxes for 1951 in the amount of $23,137.23 plus interest, which was paid on October 27, 1953, December 15, 1954, and February 9, 1955. This determination resulted from the Commissioner's treatment of the $36,000 as ordinary income instead of capital gain.

16. Elsa Wineman died in 1952 and Andrew Wineman died in 1954. By order of the Probate Court of Wayne County, Michigan, dated December 2, 1954, Eugene J.

Arnfeld and Mortimer H. Meyer were appointed executors of the Estate of Elsa Wineman. By order of the same court dated January 10, 1955, Eugene J. Arnfeld and Henry J. Moses were appointed executors of the Estate of Andrew Wineman.

17. On April 7, 1954, Andrew Wineman filed a claim for the refund of $23,487.69 of 1951 income taxes and interest paid by him and his wife. On April 22, 1955, plaintiffs filed a second claim for the refund of $25,494.25 of 1951 income taxes and interest paid by Andrew and Elsa Wineman. The second claim for refund includes additional payments of 1951 income tax and interest in the amount of $1,909.34. Each of the claims for refund was based on the contention that the $36,000 profit realized by Elsa Wineman in the calendar year of 1951 from the sale of the annuity insurance policy constituted capital gain, whereas the Commissioner of Internal Revenue had assessed the 1951 income taxes upon the basis of his determination that such profit constituted ordinary income.

18. The second claim for a refund was rejected on February 1, 1956, in a notice sent by registered mail.

CONCLUSION OF LAW

Upon the foregoing findings of fact, which are made a part of the judgment herein, the court concludes as a matter of law that the plaintiffs are not entitled to recover, and the petition is therefore dismissed.

APPENDIX II

Statutes and Regulation Involved

Internal Revenue Code of 1939:

Section 117(a)(1)—

(a) DEFINITIONS.—As used in this chapter—

(1) CAPITAL ASSETS.—The term "capital assets" means property held by the taxpayer (whether or not connected with his trade or business), but does not include—

(A) stock in trade of the taxpayer or other property of a kind which would properly be included in the inventory of the taxpayer if on hand at the close of the taxable year, or property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business;

(B) property, used in his trade or business, of a character which is subject to the allowance for depreciation provided in section 23 (1), or real property used in his trade or business;

(C) a copyright; a literary, musical, or artistic composition; or similar property;

* * * * * * *

(D) an obligation of the United States or any of its possessions, or of a State or Territory, or any political subdivision thereof, or of the District of Columbia, issued on or after March 1, 1941, on a discount basis and payable without interest at a fixed maturity date not exceeding one year from the date of issue.

Section 117(a)(4)—

LONG-TERM CAPITAL GAIN.—The term "long-term capital gain" means gain from the sale or exchange

of a capital asset held for more than 6 months, if and to the extent such gain is taken into account in computing gross income;

Section 117(b)—

DEDUCTION FROM GROSS INCOME.—In the case of a taxpayer other than a corporation, if for any taxable year the net long-term capital gain exceeds the net short-term capital loss, 50 per centum of the amount of such excess shall be a deduction from gross income. . . .

TREASURY REGULATIONS 111, Sec. 29.117-1.

The term "capital assets" includes all classes of property not specifically excluded by section 117(a)(1).

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No. 624

In the Supreme Court of the United States

OCTOBER TERM, 1958

EUGENE J. ARNFELD AND HENRY J. MOSES, EXECUTORS OF THE ESTATE OF ANDREW WINEMAN, DECEASED, AND EUGENE J. ARNFELD AND MORTIMER H. MEYER, SUCCESSOR EXECUTORS OF THE ESTATE OF ELSA WINEMAN, DECEASED, PETITIONERS

v.

THE UNITED STATES OF AMERICA

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF CLAIMS

BRIEF FOR THE UNITED STATES IN OPPOSITION

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In the Supreme Court of the United States

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BRIEF FOR THE UNITED STATES IN OPPOSITION

OPINION BELOW

The opinion of the Court of Claims (Pet. App. 1a–11a) is reported at 163 F. Supp. 865.

JURISDICTION

The judgment of the Court of Claims was entered on July 16, 1958. (Pet. App. 1a.) A timely petition for rehearing was denied on October 8, 1958. (R. 33.) The petition for a writ of certiorari was filed on January 5, 1959. The jurisdiction of this Court is invoked under 28 U.S.C., Section 1255(1).

QUESTION PRESENTED

Taxpayers[1] purchased an optional deferred income policy in 1939 under which they were entitled to deposit with the insurance company amounts up to $100,000 and were entitled to receive upon maturity on January 6, 1951, either the cash value of the policy or an annuity. Taxpayers deposited a total of $81,000 with the insurance company. The cash value of the policy on January 6, 1951, was $117,330.14, consisting of the amounts deposited plus 3½% interest compounded annually. On January 3, 1951, three days prior to maturity, taxpayers sold the policy to an independent insurance agent for $117,000. Funds for this purchase were advanced by a bank which received the policy as collateral. On the following day, the bank surrendered the policy for its cash value and received $117,330.14.

The question presented is whether the sale of the policy under the circumstances described was merely a transfer of the right to receive ordinary income, in the form of accrued interest on the amount deposited, as the court below held, or constituted a sale or exchange of a capital asset, as taxpayers contend.

---

[1] The policy in question was purchased by Andrew Wineman who assigned it to his wife, Elsa Wineman, five days later. The proceeds of the policy received in 1951 were reported by them in a joint tax return filed by them for that year. The present petitioners are the executors of the estates of Andrew and Elsa Wineman who died after the occurrence of the events here in controversy. Consequently, the deceased taxpayers will be referred to as the taxpayers herein.

STATUTES INVOLVED

Internal Revenue Code of 1939:

SEC. 22. GROSS INCOME.

* * * * * *

(b) *Exclusions from Gross Income.*—The following items shall not be included in gross income and shall be exempt from taxation under this chapter:

* * * * * *

(2) [as amended by Sec. 120(d), Revenue Act of 1942, c. 619, 56 Stat. 798] *Annuities, etc.*—

(A) *In general.*—Amounts received (other than amounts paid by reason of the death of the insured and interest payments on such amounts and other than amounts received as annuities) under a life insurance or endowment contract, but if such amounts (when added to amounts received before the taxable year under such contract) exceed the aggregate premiums or consideration paid (whether or not paid during the taxable year) then the excess shall be included in gross income.

* * * * * *

(26 U.S.C. 1952 ed., Sec. 22)

SEC. 117. CAPITAL GAINS AND LOSSES.

(a) *Definitions.*—As used in this chapter—

(1) [as amended by Sec. 210(a), Revenue Act of 1950, c. 994, 64 Stat. 906] *Capital assets.*—The term "capital assets" means property held by the taxpayer (whether or not connected with his trade or business), but does not include—

* * * * * *

(4) [as amended by Sec. 150(a)(1), Revenue

Act of 1942, *supra.*] *Long-term capital gain.*—The term "long-term capital gain" means gain from the sale or exchange of a capital asset held for more than 6 months, if and to the extent such gain is taken into account in computing gross income; '

* * * * *

(b) [as amended by Sec. 150(c), Revenue Act of 1942, *supra*]. *Percentage taken into account.*—In the case of a taxpayer, other than a corporation, only the following percentages of the gain or loss recognized upon the sale or exchange of a capital asset shall be taken into account in computing net capital gain, net capital loss, and net income:

100 per centum if the capital asset has been held for not more than 6 months.

50 percentum if the capital asset has been held for more than 6 months.

(26 U.S.C. 1952 ed., Sec. 117)

STATEMENT

This action involves claims for refund of income taxes and interest paid for the year 1951 in the amount of $25,494.25. (Pet. App. 1a, 17a.)

On January 6, 1933, taxpayer Andrew Wineman purchased from the Penn Mutual Life Insurance Company an 18-year optional deferred income policy to mature when the insured reached the age of 70. The policy contained a variable deposit provision permitting the insured or his assignees to make deposits at any time not in excess of an aggregate of $100,000, unless that limit was waived by the Company, and was to mature on January 6, 1951. On January 11, 1933, taxpayer Andrew Wineman assigned the policy

to his wife, taxpayer Elsa Wineman. (Pet. App. 1a–2a, 12a.) At the time he acquired the policy, Andrew Wineman made an initial deposit of $10,000. Thereafter, additional deposits were made from time to time by Elsa Wineman, the last such deposit having been made on March 4, 1949. The total deposits amounted to $81,000, which was the cost basis of the policy at the time of the events here in question. (Pet. App. 4a, 12a, 16a.)

Andrew Wineman had purchased the policy from one Kaichen, who was a general agent for the Penn Mutual Life Insurance Company until 1941. The policy was offered by this insurance company, as well as other companies, as a conservative investment to meet the needs of persons who had suffered a decline in the value of their investments during the depression years. After the war, however, such contracts became less attractive investments and Andrew Wineman criticized Kaichen for having induced him to make a poor investment. Kaichen thereupon suggested that taxpayers sell the policy and use the proceeds to acquire common stock or other more profitable securities. Kaichen suggested a sale, rather than surrender of the policy for its cash surrender value, because he believed that an income tax saving could be realized thereby. This belief was confirmed by taxpayers' accountants. (Pet. App. 2a–3a, 12a–13a.)

The cash surrender value of the policy was $117,330.14. (Pet. App. 3a, 15a.) Kaichen suggested that the policy be sold to the National Bank of Detroit; he had no thought of purchasing the policy personally. Accordingly, Andrew Wineman and Kaichen

went to the bank on January 3, 1951, but they were informed that the bank could not legally make such a purchase. The vice president of the bank suggested, however, that Kaichen buy the policy and that the bank would lend $117,000, the agreed selling price of the contract, on Kaichen's personal note with the policy attached as collateral. (Pet. App. 13a–14a.) When Andrew Wineman became aware of the fact that the cash surrender value of the contract was slightly in excess of $117,000, and that Kaichen was making a profit of $240.77 on the transaction, he raised some objection. He waived his objection, however, upon being informed by the vice president of the bank that Kaichen was entitled to a profit for his part in disposing of the contract. (Pet. App. 13a–16a.).

Accordingly, on January 3, 1951, taxpayer Elsa Wineman transferred the policy to Kaichen for the agreed price of $117,000. This amount was borrowed from the bank with the policy pledged as collateral. On the following day January 4, 1951, the bank mailed the policy to the Penn Mutual Life Insurance Company together with a letter requesting that the cash surrender value be remitted to the bank. On January 5, 1951, Kaichen paid taxpayer Elsa Wineman $117,000, the purchase price of the policy. The cash surrender value in the amount of $117,330.14 was received by the bank on January 15, 1951, and was applied by it in payment of the loan and accrued interest thereon. The balance of $240.77 was credited to Kaichen's account. (Pet. App. 3a–4a, 14a–15a.)

According to the provisions of the policy concerning

income payments, death benefits, and cash values, the amounts deposited under the policy accumulated at 3½ percent interest compounded annually during the life of the contract. The rate of return of the contract was thus fixed. (Pet. App. 8a, 16a.)

Taxpayers filed a joint income tax return for the year 1951 in which the sum of $36,000, the difference between the cost of the policy, $81,000, and the amount received, $117,000, was reported as a capital gain. Thereafter the Commissioner of Internal Revenue determined that such gain constituted ordinary income and asserted a deficiency against taxpayers in the amount of $23,137.23 plus interest. This amount was subsequently paid. Claims for refund having been filed by taxpayers and rejected by the Commissioner, this suit followed. (Pet. App. 4a, 16a–17a.)

The Court of Claims rejected the Government's contention that the transfer of the policy did not constitute a bona fide sale or exchange, but found that the cash surrender value consisted of the amounts deposited together with accrued interest thereon. It therefore upheld the Government in its alternative contention that the transfer represented nothing more than a transfer of the right to ordinary income rather than a sale or exchange of a capital asset. Since taxpayers would have realized ordinary income if they had surrendered the policy to the insurance company instead of transferring it to Kaichen shortly before maturity, the Court of Claims was of the view that the transaction in question was merely an attempt to convert ordinary income into capital gain, a practice disapproved in *Commissioner* v. *P. G. Lake, Inc.*,

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356 U.S. 260, and other cases cited in the court's opinion.

ARGUMENT

The issue presented by this case involves nothing more than the question as to whether a right to receive ordinary income can be transformed into a capital gain merely by the transfer of the contract under which the right to ordinary income had accrued. The holding below that such a transfer of a right to ordinary income does not constitute the conversion of a capital asset is correct and is not in conflict with any decisions of this Court or of any court of appeals.

1. Under Section 22(b)(2) of the Internal Revenue Code of 1939, *supra* (p. 3), amounts received under life insurance or endowment policies or contracts are income to the extent of the excess of the amount received over the consideration paid. Such amounts are taxable as ordinary income whether received upon maturity of the policy or contract or upon surrender thereof for its cash surrender value. *Bodine* v. *Commissioner*, 103 F. 2d 982 (C.A. 3d), certiorari denied, 308 U.S. 576; *Cobbs* v. *Commissioner*, 39 B.T.A. 642, appeal dismissed, 111 F. 2d 644 (C.A. 9th); G.C.M. 18233 1937-1 Cum. Bull. 147. The contract here in question does not call for the application of any different rule. Although labeled a deferred income policy and providing for the payment of an annuity upon maturity, the policy nonetheless provided that it could be surrendered at the end of any policy year for its then cash value. It could also be surrendered upon maturity and prior to the commencement of

annuity payments as was in fact done in the present case. It was not a policy calling for the payment of premiums as they are commonly known in insurance contracts. Instead, it provided for deposits at the option of the insured up to a total of $100,000. These deposits whenever made, as the court below found, accumulated at 3½ percent compounded annually. (Pet. App. 8a, 16a.) The policy was, therefore, simply one which, at the option of the insured or his assignees, could be surrendered for an amount equal to the total deposits made thereunder plus interest thereon compounded at 3½ percent. As such, it represented a right to the return of the investment together with the accrued ordinary interest income thereon.

This Court has recently held in *Commissioner* v. *P. G. Lake, Inc.*, 356 U.S. 260, that a right to ordinary income may not be transformed into the conversion of a capital investment merely by the sale of a property right which represents nothing more than a right to ordinary income. Similarly, here, taxpayers may not transform their right to ordinary income into the sale or exchange of a capital asset merely by the sale of the insurance contract three days before maturity, where the value of such contract can be measured simply by the original investment together with the ordinary income accrued thereon. As this Court stated in *Lake, supra* (p. 265), "the lump sum consideration seems essentially a substitute for what would otherwise be received at a future time as ordinary income." And the consideration represents the value of the obtainable

income, not the increase in value of income-producing property. The future time referred to in *Lake* was a period of years thereafter; in the present case it was a matter of only a few days.

Taxpayers seek to distinguish the *Lake* decision upon the ground that it involved only a three year assignment of income from oil property. (Pet. 7.) This asserted distinction is, however, without merit. The oil payment rights involved in *Lake* were considered by this Court to be, in themselves, property interests. They were not assigned for a limited period, but would have become extinguished by their terms after a calculable period. Similarly here, the property interest would likewise be extinguished after a calculable period, namely the maturity of the policy three days after the transaction in question. In actual fact, the interest was extinguished on the following day when the purchasers surrendered the policy for its cash value. The instant facts, therefore, represent an *a fortiori* situation to that presented in *Lake, supra,* since here the transaction did not even carry with it the gloss of the sale of a property right for some seemingly indefinite future time. The substance of the transaction in *Lake* was held to be an assignment of the right to receive income; the substance of the present transaction is the same, for the facts demonstrate that the assignment was nothing more than an assignment for the purpose of immediate collection of interest income plus the amounts deposited. The principles enunciated by this Court in *Helvering* v. *Horst,* 311 U.S. 112 are therefore applicable.

This Court also held, in *Corn Products Co.* v. *Commissioner*, 350 U.S. 46, that the term "capital assets", as used in the Internal Revenue Code of 1939, must be narrowly construed and that the preferential treatment accorded capital gains was intended to relieve taxpayers from excessive tax burdens on the conversion of capital investments. Such burdens do not exist here, for the tax sought to be imposed is the tax which would have been applicable had no transfer of the policy been made. Taxpayers are merely seeking to avoid the tax consequences of the maturity of the policy by casting the transaction in the form of a sale. As this Court noted in *Lake*, however, such a "sale" is merely a substitution for what would otherwise be receivable as ordinary income.

As the court below properly noted, this problem has received consideration in a variety of contexts. It has frequently arisen in connection with the sale of partnership interests, and it has there been held that where the sale of a partnership interest carries with it the right to ordinary income previously earned, the transaction must be treated as the realization of ordinary income to the extent that the sale price reflects a transfer of the right to such income. *Helvering* v. *Smith*, 90 F. 2d 590 (C.A. 2d); *United States* v. *Snow*, 223 F. 2d 103 (C.A. 9th); *Trousdale* v. *Commissioner*, 219 F. 2d 563 (C.A. 9th). The applicable principles were well stated by the Court of Appeals for the Ninth Circuit in *United States* v. *Snow*, *supra*, as follows (p, 108):

> However, it is not decisive of the issue here presented to find that the subject matter prop-

> erly bears the capital asset label. It is a fundamental principle of federal tax law that you must regard any ordinary income derived from an income-producing capital asset as ordinary income. Consequently, the assignment of accrued ordinary income must be treated separately from the assignment of the capital asset which produced the income. * * *
>
> The general rule is that a right to receive ordinary income, produced by a capital asset, is not transmuted into a capital asset by the sale or assignment of the capital asset together with the right to receive the ordinary income. * * *

In *Hort* v. *Commissioner*, 313 U.S. 28, this Court held that the consideration received by a lessor for the cancellation of a lease was merely a substitute for what would otherwise have been ordinary income and did not represent the sale or exchange of a capital asset which could result in capital gain. Likewise, capital gain treatment has been denied upon the transfer of a right to declared dividends (*Rhodes' Estate* v. *Commissioner*, 131 F. 2d 50 (C.A. 6th)); to the transfer of a note with accrued income thereon (*Fisher* v. *Commissioner*, 209 F. 2d 513 (C.A. 6th)); to the transfer of an interest in a judgment (*Doyle* v. *Commissioner*, 147 F. 2d 769 (C.A. 4th)); to the transfer of stock options received as compensation (*Sorensen* v. *Commissioner*, 22 T.C. 321), and to the transfer of a right to accrued royalties (*Lasky* v. *Commissioner*, 22 T.C. 13, appeal dismissed, 235 F. 2d 97 (C.A. 9th), affirmed, 352 U.S. 1027). In all of these cases, as in the present case, the courts have

found that the property right transferred represented nothing more than the right to ordinary income. The transfer of such a right, as has been uniformly held, cannot be transformed into capital gain merely by the transfer of an interest in property pursuant to which the right to ordinary income accrues.

Taxpayers refer to the decision of the Tax Court in *Phillips* v. *Commissioner*, 30 T.C. 866, now pending on appeal to the Court of Appeals for the Fourth Circuit. Although that case involved the transfer of a single premium endowment policy some twelve days before maturity, the decision of the Tax Court is distinguishable. The Tax Court held only that the increment realizable on the particular policy before it did not represent interest income, but that it represented, among other things, excess premium charges resulting from more favorable insurance experience than contemplated by its actuarial computations. The Tax Court, in that case, did not decide whether the excess of the proceeds of the endowment policy over the premiums there paid constituted ordinary income, and it did not decide whether the sale of the policy therefore represented a transfer of the right to receive such income. Moreover, in view of the decisions by the Fourth Circuit in *Doyle* v. *Commissioner, supra; Home Furniture Co.* v. *Commissioner*, 168 F. 2d 312; and *United States* v. *Shafto*, 246 F. 2d 338, involving respectively a transfer of an interest in a judgment, a transfer of an interest in accounts receivable, and an assignment of leases by the lessor, the decision in *Phillips* appears incorrect if you assume that interest income is involved.

In all of these cases, the Fourth Circuit held that the substance of the transaction amounted to the transfer of a right to receive ordinary income.

2. Taxpayers also assert (Pet. 3–4) that the decision below is in conflict with the decisions in *Blair* v. *Commissioner*, 300 U.S. 5; *McAllister* v. *Commissioner*, 157 F. 2d 235 (C.A. 2d); and *Bell's Estate* v. *Commissioner*, 137 F. 2d 454 (C.A. 8th). All of these cases involved transfers of interests in life estates. The distinction between the holding in *Blair* and the rationale of the cases here relied upon was explicitly recognized by this Court in *Harrison* v. *Schaffner*, 312 U.S. 579, where this Court stated (p. 583): "Nor are we troubled by the logical difficulties of drawing the line between a gift of an equitable interest in property for life effected by a gift for life of a share of the income of the trust and the gift of the income or a part of it for the period of a year as in this case." The same distinction was recognized by the Court of Appeals for the Second Circuit in *McAllister* v. *Commissioner*, *supra*, in which the foregoing language was quoted (p. 237) and the court stated in addition (p. 237): "The distinction seems logically and practically to turn upon anticipation of income payments over a reasonably short period of time and an out-and-out transfer of a substantial and durable property interest, such as a life estate at least is." Similarly, in *Bell's Estate*, *supra*, the Court of Appeals for the Eighth Circuit drew a distinction between the transfer of an interest in a life estate and a transfer of a right to income.

The distinction thus judicially recognized is fully applicable here. We are not confronted with a transfer of a right to income for a period of years or even for a period of one year. What we have here is the transfer of the right to income for a period of one day for purposes of collection. Surely, this cannot be equated to the transfer of an equitable interest in a life estate carrying with it the equitable ownership of property for the indefinite future. Neither this Court nor the Courts of Appeals have attempted to extend the doctrine of *Blair* to the transfer of interests which were merely a substitute for the right to receive ordinary income, nor should such an extension be made here.

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted.

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